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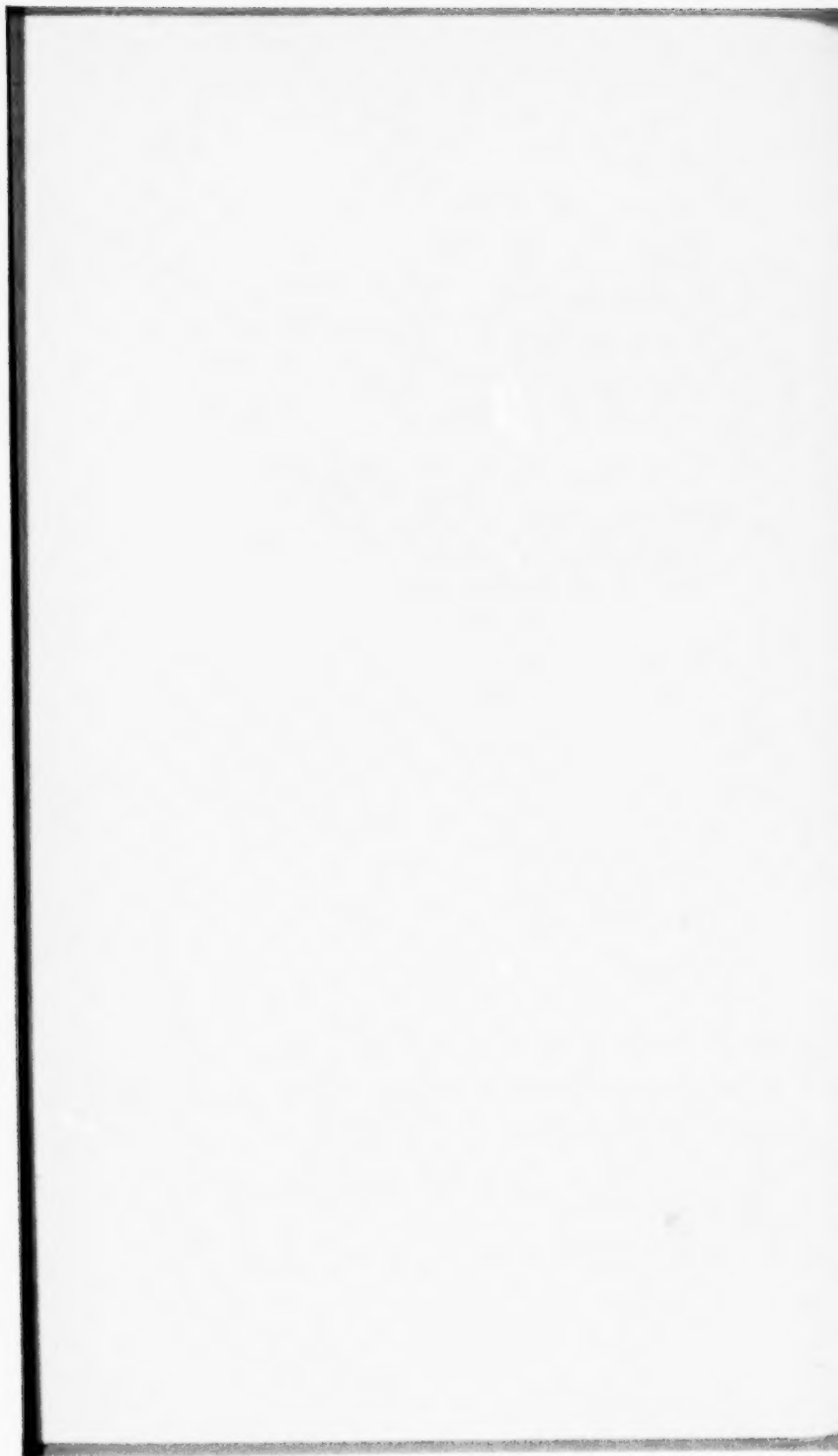
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In the Supreme Court of the United States

OCTOBER TERM, 1926

No. 291

THE UNITED STATES, PETITIONER

v.

THE S. S. WHITE DENTAL MANUFACTURING
Company of Pennsylvania

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 66) is reported in 61 Ct. Cls. Reports, page 143.

GROUND'S OF JURISDICTION

The judgment of the Court of Claims was rendered on November 9, 1925. (R. 68.) The petition for certiorari was filed February 5, 1926 (R. 69), and granted. Jurisdiction of this Court to issue the writ of certiorari to the Court of Claims is conferred by Section 3 (b) of the Act of February 13, 1925 (c. 229, 43 Stat. 936, 939).

THE QUESTION INVOLVED

The only question in the case is the right of the respondent, the owner of all the shares of stock of a German company, to deduct in 1918 from its gross income the sum of \$130,764.34, which was its investment in that German company, as a loss sustained in 1918, because in March, 1918, the German Government sequestered and took over the possession and management of the assets of the German company, although there was a substantial prospect of return of or payment for the property taken.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Section 234 of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1077, 1078), are as follows:

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; * * *.

Articles 141 and 144 of Treasury Regulations 45 provide:

ART. 141. *Losses*.—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (a) incurred in the taxpayer's

trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck or other casualty, or from theft. They must usually be evidenced by closed and completed transactions.

ART. 144. *Shrinkage in securities and stocks.*—A person possessing securities, such as stocks and bonds, can not deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of.

STATEMENT

The respondent sued in the Court of Claims to recover income taxes paid by it under protest in the amount of \$83,813.59, alleged to have been illegally collected, and claim for refund of which was denied. (R. 3 et seq.) The basis of its claim was that it had sustained a deductible loss during the year 1918 within the meaning of the provisions of the Revenue Act of 1918, above quoted, but which loss had not been allowed by the Commissioner of Internal Revenue in the computation of its net taxable income for 1918. (R. 57, 58.)

The findings of the Court of Claims show that The S. S. White Dental Manufacturing Company of Pennsylvania, the respondent, is a Pennsylvania corporation engaged in manufacturing and dealing in dental supplies. (R. 50.) In 1896 there was

organized The S. S. White Dental Manufacturing Company, m. b. h., of Berlin, Germany, of which German corporation the respondent owned a majority of the capital stock. Thereafter respondent acquired all of the outstanding shares, and since February 10, 1911, respondent has been the sole owner of the stock of the German company (R. 52), which was treated in the findings as a branch of the American company. The property of the German company seems to have been located in Germany. On March 19, 1918, the resident manager of the German company received the following notice. (R. 50.)

(Copy—Translation)

Meyers & Co. Import-Export-Commission.
Telephone: Centrum 5110. Cable address: Meyers Comp. Wilhelmstr. 42b.
ABC code, 5th edition, used

BERLIN W. 66,

Mar. 19, 1918, Wilhelmstr. 42B.

Mr. HERMAN UBERT,

Berlin-Scheneberg, Sponholzstr. 1:

Hereby I wish to inform you and request you to take note of it that I have been appointed by the minister of commerce and manufactures as sequestator of the concern The S. S. White Dental Manufacturing Company, m. b. h.

At the same time I wish to inform you hereby that from this date no further purchases in any articles are allowed any longer and deliveries and sales are to be made from the stock on hand. Orders for

which no goods are on hand must remain unfilled. The other business transactions shall be continued until further in the same manner as heretofore. About the business in general I wish to be advised every two days; about special matters at once.

As to the incoming money and the depositing of same with the bank, all necessary signatures must be given by me. Eventually I will give you power of attorney to receive money. The bank has also been advised of the above.

Yours truly,

(Signed)

EMIL MEYERS,

In the firm of Meyers & Co.

The German assets were thereupon taken over and the business of the German company operated by the German sequestrator. There is nothing in the record in the nature of proof of German law to show the exact legal effect of this sequestration, and the case was not closely tried on that point, but the findings show that the income tax unit of the Bureau of Internal Revenue once concluded (R. 54) that "this sequestration apparently corresponds to the taking over of the property of alien enemies in the United States by the Alien Property Custodian," and the dealings by the sequestrator with the German company and its assets and the disposition of them made during and after the war by the German authorities as disclosed by the findings may justify the inference that the sequestration was similar in legal effect and purpose to that accom-

plished under the Trading with the Enemy Act of the United States. The German company and its property was managed under the direction of the German sequestrator until March 15, 1920, when the possession of the German business and assets was released and returned to the German corporation and its officers. (R. 63.) In 1919 the president of the respondent went to Germany to look into affairs there, but the trip was not a success. He went again in 1921, and the affidavit he afterwards filed before the Mixed Claims Commission discloses that he then became convinced that the condition of the German company was hopeless, and in 1922 he sold its tangible assets and its lease for the sum of \$6,000, which he considered a fair value of the business under the conditions then existing. (R. 60.) The explanation of this shrinkage in assets may be found in the same affidavit before the Mixed Claims Commission. (R. 59-61.) The sequestrator in April, 1918, withdrew 50,000 marks of the company's capital and invested it in German war bonds. In June, 1918, he withdrew 40,000 more, and deposited that amount with Treuhänder, fuer das feindliche Vermögen, which translated means: Trustee for the enemy estate. (R. 60.)

Being thereby short of working capital, the sequestrator discontinued the wholesale business and continued the retail business at a loss. Besides disposing of the capital of the company for the benefit of the German Government in this way, the sequestrator seems to have consistently looted

the company for his own benefit, as he bought merchandise from the German manufacturers in his own name and then resold the merchandise to the business under his control without any disclosure of the profit he made on these transactions. (R. 61.) The shrinkage in value seems to have resulted from gross mismanagement and misconduct by the sequestrator, as well as from other disposition of assets. While the result shows that the amount received for the tangible assets and lease of the German company in 1922 was \$6,000, it does not show what has become of the German war bonds purchased by the sequestrator out of its assets, or whether there has been a total loss of that investment. In April, 1923, the respondent filed its claim before the Mixed Claims Commission on account of the loss claimed to be suffered by the German company. Details of its claim with respect to the value of the physical assets of the German corporation at the date of sequestration, March 18, 1918, are set forth in the record (R. 62), and aggregated \$161,000. On January 30, 1924, respondent received notice of an award by the Commission on its claim of the sum of \$70,000, with interest thereon at 5% per annum from February 1, 1920, to date of payment. The award included the statement (R. 66):

Of course, you will understand that an award does not mean immediate payment, as no fund has yet been provided for the satisfaction of these claims.

It is common knowledge that legislation making provision for payment of such claims has been pending in Congress, having passed the House. (H. R. 15009, 69th Congress, 2d Session.)

In some places in the record it is stated that The S. S. White Dental Manufacturing Company of Pennsylvania, this respondent, charged off in the year 1918 the then book value of its investment in the German company in the sum of \$130,764.34. (R. 51.) Elsewhere in the record it is disclosed that this is not just what the American company did. A resolution passed by its Board of Directors on July 29, 1918 (R. 55), shows that on one side of the ledger the book value of the American company's investment in the German company as of December 31, 1917, was \$130,764.34. This resolution discloses that in the year 1916 there had been charged as reserve against this amount the sum of \$20,000, so that the net book value December 31, 1917, must have been \$110,764.34. This resolution stated:

Whereas under continued condition of war the loss will, in the judgment of this board, soon be complete:

Resolved, That additional reserves be set up on the following basis, viz, \$15,000 quarterly, beginning March, 1918, until liquidated.

What the American company actually did on its books was to charge off \$20,000 in 1916 and \$15,000 quarterly commencing March, 1918. However, in making its return in 1919 for the year 1918 the

respondent made a deduction for the year 1918 of \$110,764.34, which was the full net book value of the German investment December 31, 1917, and which took into account the fact that \$20,000 of the original investment had been charged off in 1916. Later the respondent filed an amended return for 1918, in which it attempted to take a deduction of \$130,764.34 in 1918 as a realized loss in that year. (R. 53.) This claimed loss was disallowed by the committee on appeals and review of the Bureau of Internal Revenue (R. 56) and by the Commissioner (R. 58), on the ground that there was not a closed and completed transaction in 1918 and on the ground that no loss was actually sustained within the meaning of the statute unless evidenced by a closed and completed transaction.

SPECIFICATION OF ERROR

The Court of Claims erred in holding that the sequestration in 1918 resulted in that year in a sustained loss of the entire investment deductible from gross income for that year and in rendering judgment accordingly.

SUMMARY OF ARGUMENT

The decisions settle the proposition that a transaction does not produce a loss sustained, deductible under the Revenue Acts, until a point is reached where the loss is ascertained. The sequestration by Germany in 1918 of private property of American citizens found within her borders, if operating to divest the owner of title, left him with a claim for